No. 1027

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, A. D. 1944

EDWARD MALLINCKRODT, JR.,
Petitioner,

vs.

JOSEPH D. NUNAN, JR., COMMISSIONER OF INTERNAL REVENUE

PETITION FOR REHEARING FILED BY PETITIONER

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As grounds for the reversal by the Court of its judgment rendered April 9, 1945, denying the petition for writ of certiorari, petitioner states:

I. The Eighth Circuit Court of Appeals Erred in Holding That the Undistributed Income of the Trust Estate Not Received by Petitioner Was Taxable to Him as Income under Section 22(a).

(a) *Meaning of word "income" in Section 22(a) is limited by the Sixteenth Amendment*—In expanding the doctrine of the *Clifford* case by interpreting Section 22(a) to permit taxation to a beneficiary of undistributed trust income never in fact received by him from the trust estate,

the Eighth Circuit Court of Appeals failed to take into consideration the fact that the Sixteenth Amendment imposes a restraint upon the definition of income in Section 22(a).

The Sixteenth Amendment reads:

> "The Congress shall have power to lay and collect taxes on incomes, from whatever sources *derived*, without apportionment among the several States and without regard to any census or enumeration." (Emphasis supplied.)

Since Congress is not given authority to define "income" so as to include anything that is not income to the taxpayer, the word as used in the Sixteenth Amendment must be given the meaning generally ascribed to it at the time the Amendment was adopted, for only that meaning could be said to have been in the contemplation of the State Legislatures when they adopted the Amendment.

In *United States* v. *Safety Car Heating Company*, 297 U. S. 88, the Court said (p. 99):

> "Income within the meaning of the Sixteenth Amendment is the fruit that is born of capital, *not the potency of fruition.* With few exceptions, if any, it is income as the word is known in the *common speech of men.*" (Emphasis Supplied.)

In *Eisner* v. *Macomber*, 252 U. S. 189, the Court, after quoting the Sixteenth Amendment, stated (pp. 206-207):

> "A proper regard for its genesis, as well as its very clear language, requires also that this Amendment shall not be extended by loose construction, so as to repeal or modify, except as applied to income, those provisions of the Constitution that require an apportionment according to population for direct taxes upon property, real and personal. This limitation still has an appropriate and important function, and is not to be over-

ridden by Congress or disregarded by the courts. * * * Congress cannot by any definition it may adopt conclude the matter, since it cannot by legislation alter the Constitution, from which alone it derives its power to legislate, and within whose limitations alone that power can be lawfully exercised. * * * For the present purpose we require only a clear definition of the term 'income', as used in common speech, in order to determine its meaning in the Amendment; and, having formed also a correct judgment as to the nature of a stock dividend, we shall find it easy to decide the matter at issue.

"After examining dictionaries in common use (Bouv. L. D.; Standard Dict.; Webster's Internat. Dict.; Century Dict.), we find little to add to the succinct definition adopted in two cases arising under the Corporation Tax Act of 1909 (Stratton's Independence v. Howbert, 231 U. S. 399, 415; Doyle v. Mitchell Bros. Co., 247 U. S. 179, 185)—'Income may be defined as the gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained through a sale or conversion of capital assets, to which it was applied in the Doyle Case (pp. 183, 185)."

In *Sprouse* v. *Commissioner*, 122 F. 2d 973 (Cert. den. 315 U. S. 810) the Court stated (pp. 975-976):

"The meaning of the word 'income' in the Sixteenth Amendment is the same as the word has when "used in common speech" and is the gain derived from, or through a sale or conversion of, capital assets, from labor, or from both combined. *Eisner* v. *Macomber*, *supra*, 252 U. S. at page 207, 40 S. Ct. at page 193. The same case explains that income is '*not* a gain *accruing* to capital; not a *growth* or *increment* of value in the investment; but a gain, a profit, something of exchangeable value, *proceeding from* the property, *severed from* the capital, however invested or employed, and *coming in*, being '*derived*'—that is, *received* or *drawn* by the recipient (the taxpayer) for

his *separate* use, benefit and disposal—that is income derived from property. 252 U. S. at page 207, 40 S. Ct at page 193." (Emphasis supplied by the Court.)

Moreover, to be taxable under the amendment, the income must have been *"derived" by the person sought to be taxed* for it. As stated in the Sprouse case *supra, he must have "received" it "for his separate use, benefit and disposal".*

In the instant case the "income" arose from capital assets or transactions of the trust estate and was derived and owned by the trustees, not by petitioner.

Under the trust agreement as construed by the property law of Missouri, there was tendered to petitioner as a gift, so much of the annual net income of the trust estate as he might desire, but the tendered gift was upon two conditions precedent, viz; that he accept it in writing designating the amount accepted; and the second essential, as a condition precedent to a completed gift vesting the title in him, was the payment to him by the trustees of the amount so accepted (requisitioned) by him. Petitioner could not receive any of the trust income, nor could the trustees pay any of it to him, nor could he "derive" any of it, except upon performance of all of the three legal requirements for a completed gift, viz: (1) a tender of the gift,—contained in the trust instrument; (2) his acceptance of the offer,—expressed by his written request; and (3) the delivery (payment) to him of the amount requested; *Gosney* v. *Costigan,* 326 Mo. 1215, 1228; *Thomas* v. *Thomas,* 107 Mo. 459, 463; *Cartall* v. *St. Louis Union Co.,* 348 Mo. 372, 385.

In the instant case the Eighth Circuit Court of Appeals interpreted "income" under Section 22(a) in disregard of the limitations imposed by the Sixteenth Amendment. Under the trust agreement petitioner could not receive the

income of the trust from the trustees, and they could not pay it to him, unless he made demand upon the trustees for payment of the income. In 1934 and in 1935 no demand for payment of such income was made upon the trustees by petitioner. In 1936 and in 1937 only small amounts were paid by the trustees to third parties at the request of petitioner. The undistributed trust income for each of the four years became part of the principal of the trust estate. Obviously, petitioner did not "derive", have possession or use of, or title to, any part of the undistributed trust income which he did not demand or receive; nor did he have title to or dominion over any part of the corpus of the trust. Nevertheless, the Eighth Circuit Court of Appeals taxed the undistributed trust income to petitioner on the theory that "the power of petitioner to receive this trust income each year, upon request, can be regarded as the equivalent of ownership of the income for purposes of taxation." (R. 363.) The Court ignored the obvious fact that petitioner received no income because he did not exercise the power. Such *lack of income* to petitioner was not "income *derived*" within the meaning of "income" in Section 22(a), or under the Constitution, or as the word "income" is known in the "common speech of men".

(b) *Section 22(a) is not a tax-enacting statute whereas Section 161(b) imposes a tax upon the fiduciary.*—In its opinion the Eighth Circuit Court of Appeals relies upon Section 22(a) as the authority for levying the tax on petitioner as the beneficiary of the trust. Section 22(a) is not a tax-enacting statute. No income tax is fixed or levied by it. It is a definition section. Moreover, nowhere in Section 22(a) is there any language which fastens upon a beneficiary the undistributed income of a trust, which income has never been received by the beneficiary but has been retained by the trust estate.

On the other hand, Section 161(b) specifically directs that the tax upon the net income of a trust estate shall be paid by the *fiduciary*. In the instant case the undistributed trust income not demanded by or paid to petitioner as beneficiary became part of the principal of the trust at the end of each year and was "income accumulated or held for future distribution under the terms of the will or trust" within the unambiguous provisions of Section 161(a)(1), and was taxable solely to the trust estate under Section 161(b).

(c) *Section 22(a) does not tax to petitioner such possibility of receiving income as he held under the trust.*—In the instant case an irrevocable trust was created by the grantor under the laws of Missouri, and it is these laws that govern the legality, construction and administration of the trust. *Helvering* v. *Stuart*, 317 U. S. 154, 162. Under the laws of Missouri "a power is wholly ineffective until it is exercised" and a "power" is not the equivalent of ownership of the income which is subject to the power. *Citizens Bank of Lancaster* v. *Foglesang*, 326 Mo. 581, 31 S. W. 2d 778, 782.

The Federal Revenue Acts must designate what interests or rights created under State laws shall be taxed, if any tax is to apply. The Congress has *not* fixed a tax (under Section 22(a) or otherwise) on such a *possibility* of receiving income, to be determined under the laws of Missouri, as petitioner had in the pending case. Quite to the contrary, the Congress has specifically provided in Section 161(b) that the tax upon the net income (including undistributed income) of a trust estate shall be paid by the *fiduciary*. Therefore, the Eighth Circuit Court of Appeals not only expanded the meaning of Section 22(a) by judicial legislation but at the same time it judicially repealed Section 161(b) of the Revenue laws. Such a decision puts the Commissioner of Internal Revenue in a position where he may,

at will, fix the tax on trust income upon the trust estate, or the beneficiary, depending upon which allocation will produce the greatest revenue. Obviously, the specific language of Section 161 gives to the Commissioner no such authority. This Court should not permit him to assume such power through the medium of misconstruing Section 22(a) and expanding the doctrine of the *Clifford* case.

In other situations, complete power over income has not been sufficient to make the income taxable to the holder of the power. If a man incorporates his business and wholly owns the corporation, he is not taxed on gains from sales by the corporation of its property, but such income is taxable to the corporation. *Moline Properties Inc.* v. *Commissioner*, 319 U. S. 436. If the corporate entity must be recognized in the taxation of the income of a corporation, the same reasoning requires that the *trust entity* established by Sections 161 and 162 must be recognized in the taxation of the undistributed income of a trust.

II. Adherence to, and Fair Interpretation of, Statutes Taxing Trust Income Are Matters of Vital Public Importance.

The Eighth Circuit Court of Appeals failed to give any effect to Sections 161 and 162 after correctly analyzing these sections. It brushed the sections aside and based its decision upon the novel theory that "implications" deducible from the *Clifford* case superseded the clear Congressional intent expressed in Section 161(b) to tax the undistributed trust income solely to the *fiduciary*.

Thousands of trusts are in existence and were created in reliance upon the legislative policy for their taxation as expressed in unambiguous statutes since 1928. Many trusts are being and will be created daily throughout the United States. In a large proportion of such trusts the protection

of wives, children and dependents will be the controlling motive. In fairness to all parties concerned there should be stability in the interpretation and application of unambiguous taxing statutes upon which the public has the right to rely. Judicial repeal of such statutes on any pretext whatsoever will have an unjust retroactive effect which cannot be remedied in many instances. Forcing the public to speculate upon the effect of the judicial repeal of existing statutes taxing trust estates will impose undue hardships upon those who seek to guide their conduct under the statutes as enacted by the Congress.

Judicial repeal of the statutes taxing trust estates will inevitably force the public to demand that the Congress exercise its legislative authority by enacting new legislation to set aside decisions which disregard the Congressional intent. This the Congress recently did in amending Section 167 by enacting Section 134 of the Revenue Act of 1943 so as to consummate a retroactive legislative repeal of *Helvering* v. *Stuart*, 317 U. S. 154. See *Estate of Banfield*, 4 T. C. 29, 31-33. In the meantime, and until the Congress does legislate to repeal such decisions, the public will suffer from the chaotic condition of the trust laws designed to tax income from trust estates due to the unjustified assumption of legislative authority by the courts based upon inferences from the *Clifford* case and other cases.

The various lower courts have no semblance of adequate standards to guide them in applying the so-called Clifford doctrine. In *Stockstrom* v. *Commissioner*, decided March 23, 1945, by the Circuit Court of Appeals for the Eighth Circuit and not yet officially reported, Judge Sanborn (who wrote the opinion in the instant case), in recognizing the utter inability of the lower courts to apply the Clifford doctrine, said (P-H, 1945, ¶ 72,465):

> "I think the Tax Court might well have decided this case in favor of the taxpayer, but the standard for

> determining to whom the income was taxable is presently so vague and indefinite that I have no conviction as to whether the decision of the Tax Court is, as a matter of law, right or wrong. I therefore concur. I think it is unfortunate that courts which are required to determine such controversies as this must express opinions which are obviously little more than guesses. The number of cases in which the doctrine of *Helvering* v. *Clifford*, supra, is invoked indicates the difficulty which the Bench and Bar are having in applying that doctrine. See Shepard's United States Citations on 309 U. S. 331."

Another instance in which a Circuit Court of Appeals is uncertain about how to apply the doctrine of the *Clifford* case to a given state of facts is found in *Commissioner* v. *Bateman*, 127 F. 2d 266, in which the Circuit Court of Appeals of the First Circuit, in a unanimous opinion upholding a decision of the Board of Tax Appeals, said (p. 271):

> "Frankly we do not know how the Supreme Court would apply the general criteria of the Clifford case to the facts now before us. We have to make our decision with such light as is available to us."

Again, after reviewing many prior decisions including that in the *Clifford* case, the Court said (p. 274):

> "This review of the cases still does not indicate to us as clearly as we should wish, how the case at bar should be decided."

So it appears that confusion exists in at least two of the Circuit Courts of Appeals as well as in the Tax Court, about just what the doctrine of this Court in the *Clifford* case is, and what its limitations are.

The Tax Court was divided on the applicability of the *Clifford* case to the instant case. Circuit Judge John B. Sanborn who wrote the opinion of the Court of Appeals in the instant case, has more recently expressed his doubt

in *Stockstrom* v. *Commissioner*, cited and quoted from above; and the Circuit Court of Appeals of the First Circuit has expressed its uncertainty in the above quotations from the opinion in *Commissioner* v. *Bateman*.

It is respectfully submitted that these clear evidences of confusion in the minds of at least two different Circuit Courts of Appeals, as well as in the Tax Court, constitute strong evidence of the urgent public need for a ruling of the Court in the instant case, as to whether the Circuit Court of Appeals was justified in ignoring the statutory requirements of Sections 161 and 162, merely because of a judicial inference from the Clifford decision, thereby allowing such inference to override expres provisions of a statute.

Conclusion

For these reasons it is respectfully submitted that this petition for rehearing should be granted and that the Court should reverse its prior judgment and grant the petition for writ of certiorari.

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April, 1945.

Certificate of Counsel

I, Mac Asbill, of counsel for petitioner, do certify that the foregoing petition for rehearing is presented in good faith and not for delay.

MAC ASBILL.